

*Example 7.* X and Y are members of the same group of controlled entities. X manufactures product D for distribution and sale in the United States, Canada, and Mexico. Y manufactures product D for distribution and sale in South and Central America. Due to a breakdown of machinery, Y is forced to cease its manufacturing operations for a 1-month period. In order to meet demand for product D during the shutdown period, Y sends partially finished goods to X. X, for that period, completes the manufacture of product D for Y and ships the finished product back to Y. The costs or deductions of X related to the manufacturing services rendered to Y are \$750,000. The total costs or deductions of X are \$24,000,000. Since the services in issue constitute a manufacturing activity, the 25-percent test in paragraph (b)(7)(ii) of this section does not apply. However, under these facts and circumstances, i.e., the insubstantiality of the services rendered to Y in relation to X's total operations, the lack of regularity with which the services are rendered, and the short duration for which the services are rendered, X's rendition of manufacturing services to Y is not considered one of X's principal activities within the meaning of paragraph (b)(7)(ii) of this section.

*Example 8.* Assume the same facts as in *Example 7*, except that, instead of temporarily ceasing operations, Y requests assistance from X in correcting the defects in the manufacturing equipment. In response, X sends a team of engineers to discover and correct the defects without the necessity of a shutdown. Although the services performed by the engineers were related to a manufacturing activity, the services are essentially supporting in nature and, therefore, do not constitute a manufacturing, production, extraction, or construction activity. Thus, the 25-percent test in paragraph (b)(7)(ii) of this section applies.

*Example 9.* X is a domestic manufacturing corporation. Y, a foreign subsidiary of X, has decided to construct a plant in Country A. In connection with the construction of Y's plant, X draws up the architectural plans for the plant, arranges the financing of the construction, negotiates with various Government authorities in Country A, invites bids from unrelated parties for several phases of construction, and negotiates, on Y's behalf, the contracts with unrelated parties who are retained to carry out certain phases of the construction. Although the unrelated parties retained by X for Y perform the physical construction, the aggregate services performed by X for Y are such that they, in themselves, constitute a construction activity. Thus, the 25-percent test in paragraph (b)(7)(ii) of this section does not apply with respect to such services.

*Example 10.* X and Y are members of the same group of controlled entities. X is a finance company engaged in financing auto-

mobile loans. In connection with such loans it requires the borrower to have life insurance in the amount of the loan. Although X's borrowers are not required to take out life insurance from any particular insurance company, at the same time that the loan agreement is being finalized, X's employees suggest that the borrower take out life insurance from Y, which is an agency for life insurance companies. Since there would be a delay in the processing of the loan if some other company were selected by the borrower, almost all of X's borrowers take out life insurance through Y. Because of this utilization of its influential relationship with its borrowers, X is peculiarly capable of rendering selling services to Y and, since a substantial amount of Y's business is derived from X's borrowers, such selling services are a principal element in the operation of Y's insurance business. In addition, the value of the services is substantially in excess of the costs incurred by X. Thus, the selling services rendered by X to Y are an integral part of the business activity of a member of the controlled group as described in paragraph (b)(7)(iii) of this section.

*Example 11.* X and Y are members of the same group of controlled entities. Y is a manufacturer of product E. In past years product E has not always operated properly because of imperfections present in the finished product. X owns an exclusive patented process by which such imperfections can be detected and removed prior to sale of the product, thereby greatly increasing the marketability of the product. In connection with its manufacturing operations Y sends its products to X for inspection which involves utilization of the patented process. The inspection of Y's products by X is not one of the principal activities of X. However, X is peculiarly capable of rendering the inspection services to Y because of its utilization of the patented process. Since this inspection greatly increases the marketability of product E it is extremely valuable. Such value is substantially in excess of the cost incurred by X in rendition of such services. Because of the impact of the inspection on sales, such services are a principal element in the operations of Y. Thus, the inspection services rendered by X to Y are an integral part of the business activity of a member of the controlled group as described in paragraph (b)(7)(iii) of this section.

*Example 12.* Assume the same facts as in *Example 11* except that Y owns the patented process for detecting the imperfections. Y, however, does not have the facilities to implement the inspection process. Therefore, Y sends its products to X for inspection which involves utilization of the patented process owned by Y. Since Y owns the patent, X is not peculiarly capable of rendering the inspection services to Y within the meaning of paragraph (b)(7)(iii) of this section.